

CONTRACT & LEASE ASSUMPTION: HOW FAR DO YOU GO?

David B. Wheeler¹

A lease & contract assumption by the debtor is supposed to return the counter-party to “square one”, right? The First Circuit Court of Appeals has determined the answer to this inquiry to be “not necessarily”. Rejecting the 1997 Ninth Circuit decision, *In re Claremont Acquisition Corp.*, 113 F.3^d 1029, the First Circuit Court of Appeals recently ruled that the cure obligation under § 365(b) is limited to monetary default. In the case of *Eagle Ins. Co. v. BankVest Capital Corp.* (*In re BankVest Capital Corp.*), 2004 US App. LEXIS 4810 (March 15, 2004), the Circuit Court took on the issue of whether § 365(b)(2)(D) permits a debtor-in-possession to assume an unexpired equipment lease without first curing non-monetary defaults. Pre-petition, BankVest agreed to lease 190 pieces of computer equipment to Eagle Insurance and another insurance company for a term of 48 months. Some of the equipment however was unavailable from the manufacturer at the onset of the lease term and therefore “loaner equipment” was agreed to be provided until such time as the manufacturer would be in a position to deliver the equipment specified in the leases. BankVest was the subject of an involuntary petition for bankruptcy and ultimately an order for relief was issued. Needless to say, the involuntary petition was awarded before the “loaner equipment” could be replaced. The insurance companies continued to use the equipment

¹ **Moore & Van Allen, PLLC**
40 Calhoun Street, Suite 300
Charleston, SC 29401
(843) 579-7015
(843) 579-8727 fax
davidwheeler@mvalaw.com

but suspended their lease payments, accumulating an arrearage under the lease in excess of \$1,000,000!

A plan approved by the bankruptcy court included a provision for the assumption of the equipment leases under certain terms. The lessee insurance companies objected to the assumption terms, stating that cure was either (1) impossible due to the debtor's failure to provide the proper equipment (i.e., "a historical fact not susceptible to cure") or (2) damages in excess of \$300,000, as well as reductions in the rent payments owed to the debtor.

In the ensuing hearing the bankruptcy court found § 365 (B)(2)(D) permits a debtor-in-possession to assume a contract or a lease without first curing non-monetary defaults. Because the debtor was not in default on any monetary provision (all of the payments under the subject leases flowed to the debtor), there would be no cure claims that had to be satisfied as a prerequisite to assumption. Upon appeal, the Bankruptcy Appellate Panel agreed.

On appeal, the First Circuit chose to draw its own conclusion as to the need for a comprehensive cure of all defaults under a lease or contract, rather than simply taking the lead from the Ninth Circuit's *Claremont Acquisition Corp.* ruling that both monetary and non-monetary breaches must be cured as a prerequisite to assumption.

The First Circuit found neither the plain text nor the legislative history of the Bankruptcy Code provision instructive. The Court chose to consider the “practical implications” of requiring comprehensive cure rather than monetary cure and was troubled by the dilemma posed by requiring a debtor-in-possession to cure non-monetary defaults when such defaults are often impossible to cure. Such a broad requirement was viewed as a roadblock to achieving a “fresh start”. Moreover, the Court analogized a comprehensive cure obligation to the type of “ipso facto” default provisions prohibited under the Bankruptcy Code. In reaching this conclusion however, the Court was careful to emphasize that assumption did not prevent the insurance companies from raising defenses to any payment demand by the debtor or for the counter-claim of damages for any losses actually suffered by BankVest’s alleged breach.

As a result of this decision there is now a split among the Circuits on this issue. Which opinion the court in which your case is pending will choose to follow will play a significant role in how aggressive a trade creditor should be in negotiating cures to leases and executory contracts to which it is a party.